

ANNOUNCEMENT

The REVIEW takes pleasure in announcing the election of the following members of the Second Year Class. To the Editorial Board: Alexander F. Barbieri, Walter Beachboard, James W. Bertolet, K. Wilde Blackburn, John C. Bruton, Jr., Bernard F. Cataldo, Harold C. Cohen, Saul Finestone, B. Friedman, James E. Gallagher, Jr., Charles R. Hindley, Israel Packel, Herbert N. Shenkin, Herbert J. Slaughter, David J. Speck. To the Business Board: Samuel A. Blank, Edward I. Harburg, Bernard A. Master, Harold R. Prowell.

NOTES

CONFLICTING CLAIMS OF PREFERRED AND COMMON SHAREHOLDERS WITH RESPECT TO CORPORATE "PROFITS"—In the recent case of *Murphy v. Richardson Dry Goods Company*¹ the Supreme Court of Missouri decided that preferred shares created under articles of association which provided that "said preferred shares shall be entitled to a dividend of 6 per cent. *per annum* out of the net yearly income earned in any one current year before any dividend shall be made and paid on the common shares of said corporation, and which said preferred shares shall, upon distribution of the assets of the corporation, be first paid in full before any of said assets are applied to any of the common shares, . . .", did not entitle the holders thereof (1) to participate equally with the holders of the unpreferred shares in the distribution of surplus assets upon dissolution, or (2) to receive out of such surplus assets an amount equal to the preferred dividends not earned in two preceeding years; in short, the court held that the preferred shares were non-participating and non-cumulative.

This decision involves the following important problem, to which the courts of this country have as yet given little consideration: what allocation is to be made of corporate "profits"² by a corporation among several different classes of shareholders, either while the corporation is a "going concern" or is in the process of liquidation. That such "profits" belong to the shareholders, whether they be distributed as dividends or remain as surplus assets after the company has ceased to be a "going concern", is uncontraverted; the question is, to what class of shareholders do the "profits" belong.

There are two situations in which this problem may arise: first, when the company is a "going concern" and as a result of either an accumulation of undivided yearly net earnings or an increase in the value of properties owned by it, has a surplus which it wishes to dis-

¹ 31 S. W. (2d) 72 (Mo. 1930).

² By the term "profits" here is meant both surplus of a going concern and surplus assets of a liquidating company.

tribute in the form of dividends; second, when the company winds up its affairs and, after paying all its obligations to creditors, and setting aside a sum equal to the "capital" contribution of its shareholders, has a surplus to distribute among the shareholders.

Distribution of Dividends by a Going Concern

The relation existing between the shareholders and the corporation, and between the shareholders *inter se* is established by judicial interpretation of the provisions of the applicable statutes, the articles of association, the by-laws and share certificates.³ In general, these four sources of judicial interpretation constitute a hierarchy in the order named, *i. e.* in case of conflict the applicable statutes are of most importance and the share certificate of least. But it should be noted that there are practically no statutory provisions bearing upon the problem with which this note is concerned.

With respect to the allocation of dividends among shareholders, shares may be of four classes: 1. preferred and limited; 2. preferred and unlimited; 3. unpreferred and limited; 4. unpreferred and unlimited.⁴ Certain principles are clear; the limited shares, whether preferred or unpreferred, cannot participate in profits *pari passu* with the unlimited shares⁵ beyond the limitation provided. Likewise, unlimited shares are entitled to participate rateably in any distribution of profits beyond a stated preference and, with respect to such excess distribution, it is immaterial whether they be preferred

³ See *Continental Ins. Co. v. Minneapolis, etc. Ry.*, 290 Fed. 87 (C. C. A. 8th, 1923), *certiorari* denied, 263 U. S. 703, 44 Sup. Ct. 33 (1923); *Stone v. United States Envelope Co.*, 119 Me. 394, 111 Atl. 536 (1920); *Thomas v. Laconia Car Co.*, 251 Mass. 529, 146 N. E. 775 (1925).

⁴ *i. e.* 1. non-participating preferred; 2. participating preferred; 3. non-participating unpreferred; 4. participating unpreferred or "common". This same classification may be made with respect to capital distributions depending upon whether the shares are preferred or unpreferred, limited or unlimited, as to repayment of capital contribution on dissolution. Thus by dealing with each class in respect to dividends in combination with any one of the four as to capital contribution it is possible to have at least sixteen different kinds of shares for the purpose of allocation of "profits". See Frey, *Shareholders Pre-emptive Rights* (1929) 38 YALE L. J. 563, 566. However, in this note, the four divisions as to dividends, and the four divisions as to assets on dissolution are considered separately. Shares which are partly participating beyond a preferential amount are not dealt with herein.

⁵ In *Scott v. Baltimore and Ohio Railroad Co.*, 93 Md. 475, 49 Atl. 32 (1901), shares were created under a "plan and agreement" which provided that preferred shares were to receive a non-cumulative preference dividend *not exceeding* four per cent. *per annum*. The court held that the words "not exceeding" would be mere surplusage if the preferred shares were allowed to participate further than four per cent. In *Equitable Life Assurance Society v. Union Pacific Railroad Co.*, 212 N. Y. 360, 106 N. E. 92 (1914), it was held that preferred shareholders could not participate in surplus profits further than four per cent. under articles of association which, after stating the preference, continued "and the preferred stock is entitled to no other or further share of the profits."

or unpreferred.⁶ Thus the question narrows down to this: when, if ever, are shares limited other than in cases where a limitation is specifically expressed in the corporate instruments?⁷

In respect to unpreferred shares there is no difficulty of interpretation because, unless the shares are preferred or dividends are guaranteed,⁸ no basis for limitation of dividends is presented.⁹

A more difficult case is presented where the corporate instruments provide that certain shares are to be preferred in the payment of dividends to a stipulated amount, but are silent as to the limitations, if any, of such shares to participate in dividend payments beyond the amount of this preference. Such a provision might be interpreted as limiting the preferred shareholders to the preferential amount with respect to dividends, or interpreted as not so limiting them. Most text writers and compilers of digests dismiss the problem with the statement that unless the corporate instruments provide otherwise, preferred and unpreferred shareholders participate equally in any distribution of profits, after the unpreferred have received a dividend equal to the preference dividend.¹⁰ While the provisions of the corporate instruments vary slightly in many cases, in a majority of instances they merely specify that certain shares shall be entitled to a specified preferential dividend.¹¹ Thus courts, though in some cases enabled to seize upon an obscure fact to avoid facing a direct issue,¹² are usually confronted with the question whether a specified preference to dividends negatives any further rights in respect to

⁶ *Continental Ins. Co. v. Minneapolis, etc. Ry. Co.*, *supra* note 3; *Gordon's Ex'rs v. Richmond F. & P. R. Co.*, 78 Va. 501 (1884); BALLANTINE ON CORPORATIONS (1927) § 161; see Berle, *Participating Preferred Stock* (1926) 26 COL. L. REV. 303.

⁷ The term "corporate instruments" as here used means the articles of incorporation, by-laws, and share certificates.

⁸ Dividends cannot be guaranteed by the corporation issuing the shares as this would make the shareholders creditors of the corporation, *Warren v. Queen*, 240 Pa. 154, 87 Atl. 595 (1913). Nevertheless it is possible for some "third person" to guarantee such dividends, *e. g.* a parent corporation could guarantee dividends to shareholders of one of its subsidiary corporations.

⁹ Unless the corporate instruments provide for some other disposition of any surplus, this fund belongs to the shareholders. If a specified disposition is stated, there is no question of construction. See, for example, the reference to the shares of the Citizens Gas Co. of Indianapolis in *Frey, op. cit. supra* note 4, at 567, n. 12.

¹⁰ See 14 C. J. § 573; 7 R. C. L. 287; 1 COOK ON CORPORATIONS (8th ed. 1923) § 269.

¹¹ The provision of the articles of association in *Murphy v. Richardson Dry Goods Co.*, *supra* note 1, is in substance similar to the provision in most corporate instruments with respect to preferences.

¹² In the recent English case of *Collaroy Company, Ltd. v. Giffard*, [1927] 1 Ch. 144, the articles provided that "the preference shares shall confer the right to a fixed cumulative preferential dividend . . .". The court held that the use of the term "the right" instead of "a right" showed conclusively that it was not intended that the preferred shares should have any right other than the preference.

participation. A review of the decided cases shows the existence of two distinct and conflicting principles, both of which are sufficiently broad to include any case where the provisions of the articles are silent in respect to participation in surplus profits.

The first of these two opposing theories seems to have its origin in the Pennsylvania case of *Fidelity Trust Company v. Lehigh Valley Railroad Company*,¹³ decided in 1906, and in effect is that all shares are equal except for the preference stated; that preferred shareholders have all the ordinary incidents of shareholders together with any preferences specifically given. By this view, which has been steadfastly adhered to in Pennsylvania,¹⁴ but nowhere else except by way of *dictum*,¹⁵ preferred shareholders are not limited to the amount of their preference as to dividends unless the corporate instruments in express terms provide for a limitation.

Opposed to this so-called "Pennsylvania doctrine" are the only two cases¹⁶ in which the problem has come up in this country other

¹³ 215 Pa. 610, 64 Atl. 829 (1906).

¹⁴ The *Fidelity* case was followed by *Sternbergh v. Brock*, 225 Pa. 279, 74 Atl. 116 (1909), which cited the *Fidelity* case as controlling. This view was further strengthened in Pennsylvania by *Sterling v. Watson*, 241 Pa. 105, 88 Atl. 297 (1913) and *Englander v. Osborne*, 261 Pa. 366, 104 Atl. 614 (1918) where the court said, "The priority of preferred shareholders rests upon the contract, and beyond its provisions they occupy no position in relation to the corporation different from that of the holders of common stock."

¹⁵ In *In re Espuela Land and Title Co.*, [1909] 2 Ch. 187, the issue was distribution of surplus assets on dissolution, the court, however, used the following language, "There is not any rule of law that shareholders having a fixed preferential dividend take that only. It is quite open to a company to distribute its revenue first in paying a fixed preferential dividend, then in paying a dividend of a like amount to the ordinary shareholders, and then dividing any surplus of any year rateably between the preference and ordinary shareholders." For a discussion supporting the Pennsylvania view see Christ, *Right of Holders of Preferred Stock to Participate in the Distribution of Profits* (1929) 27 MICH. L. REV. 731.

¹⁶ In *Niles v. Ludlow Valve Mfg. Co.*, 202 Fed. 141 (C. C. A. 2d, 1913) it was held that shareholders who had been given a preference by a certificate of incorporation which provided that preference shares should be "entitled to a fixed yearly dividend of eight per cent. which is to be paid before any dividend can be declared on the common stock", were not entitled to any interest in accumulated net earnings beyond the eight per cent. preference. The court reasoned that the preference implied a limitation. In *Stone v. United States Envelope Co.*, *supra* note 3, the court refused to allow shareholders who had been given a preferential dividend to share with unpreferred shareholders in distribution of surplus profits by way of a share dividend, on the ground that the ordinary buyer of preferred shares buys with the understanding that the maximum of his right to share in dividends is fixed by the fact of preference and at the amount of preference. Said the court, "The creation of the preferred stock implies that the preferential rights of the [preferred] shareholders are given in lieu of and to the exclusion of the equality of participation which should otherwise exist."

than in Pennsylvania, and the one case¹⁷ in which the problem has been decided in England. These courts take the stand that the specified preference is given in lieu of the unlimited participation in dividend payments which would otherwise exist. By this view preferred shareholders are limited to the amount of their preference as to dividend payments even though the corporate instruments do not in terms provide for such limitation. In England this view was taken in spite of *dictum* in a previous case favoring the position taken by the Pennsylvania courts.¹⁸

In none of the cases taking one of these two theories were any factors considered other than the provisions of the corporate instruments. The Supreme Court of Virginia decided a case¹⁹ approximating the same problem on equitable considerations. A thorough analysis of the problem indicates that the terms of the corporate instruments, while a very important factor, is only one of a number of circumstances which ought to be weighed in determining the solution to this problem. Such other factors are mentioned subsequently in this note.²⁰

Distribution of Surplus Assets on Winding Up

In the English case of *Wills v. United Lankat Plantations Company*,²¹ Farwell, L. J., made the following observation: "To my mind the considerations affecting capital and dividend are entirely different. The preference given to capital is in the winding up, and the

¹⁷ In *Will v. United Lankat Plantations Co.*, [1912] 2 Ch. 571, *aff'd* by House of Lords [1914] A. C. 11, preferred shareholders were denied the right of further participation. Lord Haldane, at 17 "Shares are not issued in the abstract and priorities attached to them *in toto*; and when you turn to the terms on which the shares are issued you expect to find all the rights as regards dividends specified in the terms of the issue."

¹⁸ *In re Espuela Land and Title Co.*, *supra* note 15.

¹⁹ *Riverside & Dan River Cotton Mills v. Branch & Co.*, 147 Va. 509, 137 S. E. 620 (1917). In this case a surplus was to be distributed in the form of voting shares and it was held that preferred shareholders were entitled to participate in share dividends beyond the amount of their preference even though their right to dividends was limited to the preference given. The court reasoned that an increase of shares in which the preferred shareholders did not participate would decrease the value of their rights upon dissolution, and that if they had (as in this case) equal voting power with the unpreferred shares, an increase in the number of shares would decrease the proportionate strength of the preferred in management-control, unless they were given a proportionate part of the shares so created. While the question raised in this case was primarily one of pre-emptive right, the court went much further than have even the Pennsylvania Courts in holding that the preferred shareholders were entitled to participate even though expressly limited, when to enforce such limitation would cause an inequitable result. This case, while not strictly within the scope of this note, advances an idea not to be overlooked: *i. e.* equitable considerations as determining factors when the corporate instruments are clear as to preference and silent as to participation.

²⁰ *Infra* note 37.

²¹ *Supra* note 17.

preference claimed to be given to dividends here is in a going concern." Commenting on this statement, Astbury, J., in *Collaroy Company v. Giffard*,²² said, "Now it seems plain that different considerations may, and to some extent do, affect the respective questions of capital preference and dividend preference. But whether the considerations affecting them are 'entirely different' is a question of some difficulty."

In spite of these statements by the English courts to the effect that the questions of preferred shareholders' rights to participate in dividend payments and to participate in surplus assets on dissolution should be governed by different considerations, no actual distinctions have been pointed out by any of the decided cases.

As a general rule a preference with respect to dividends does not affect such preferred shareholders' rights with respect to distribution of assets on dissolution; if there are surplus assets they participate *pari passu* with the unpreferred shareholders;²³ if the assets are insufficient to repay all "capital" contributions, it has been held that they get no preference in repayment.²⁴ The case which presents the difficult problem, as in distribution of surplus profits, is when a definite preference with respect to repayment of "capital" contribution on dissolution is specified by the corporate instruments and nothing is said concerning a limitation with respect to participation in surplus assets.

Only two cases concerning this precise problem have come up in the United States,²⁵ both of which proceeded on the theory that the provision of the corporate instruments that the preferred shareholders be "paid in full" on dissolution before the unpreferred be paid anything impliedly negated any further right in such preferred shares to participate in surplus assets. These courts fail to make any distinction between participation in profits while the company is a going concern and participation in surplus assets on dissolution.²⁶ Whether this failure to distinguish between the two situations was

²² *Supra* note 12.

²³ *Birch v. Cropper*, 14 App. Cas. 525 (1889); see *Continental Insurance Company v. United States*, 259 U. S. 156, 181, 42 Sup. Ct. 540, 548; *BALLANTINE ON CORPORATIONS* (1927) 534.

²⁴ *Lloyd v. Pennsylvania Electric Vehicle Co.*, 75 N. J. Eq. 263, 72 Atl. 16 (1909).

²⁵ *Murphy v. Richardson Dry Goods Co.*, *supra* note 1, and *Williams v. Renshaw*, 220 App. Div. 39, 220 N. Y. Supp. 532 (1927). In this latter case the certificate of incorporation provided that "preferred shares shall receive non-cumulative dividends each year before any dividends shall be declared on the common shares, and upon dissolution of the company and distribution of its assets the preferred shares shall be paid in full at par before any amount shall be paid on account of the common shares."

²⁶ While *Murphy v. Richardson Dry Goods Co.*, *supra* note 1, cited only *Williams v. Renshaw*, *supra* note 25, in support of its stand, this latter case seemed to rely strongly on *Niles v. Ludlow Valve Co.*, *supra* note 16, a case which concerned the distribution of surplus profits while the company was a "going concern".

due to an unawareness of any difference, or to a conception that there is no value in such a distinction is not evident. It will be interesting to see how this problem will be treated in Pennsylvania if it arises. It is difficult to see how the Pennsylvania courts could do otherwise than come to an opposite conclusion from these two cases.²⁷

The English courts have, with one exception,²⁸ taken a different stand from the two American cases. The question has come up four times. In *In re Espuela Land & Title Company*²⁹ the memorandum of association provided for a cumulative preferential dividend and a preferential right to be repaid the amount of "capital" contribution out of the assets of the company on dissolution. It was held that this preference with respect to repayment on dissolution was in no sense a limitation on the right to participate in surplus assets. A contrary view, in accord with the two decisions in this country, was taken by the court in the later case of *In re National Telephone Company*³⁰ where it was held that when the corporate instruments specify a preference as to "capital" distribution, that *prima facie* impliedly negatives the existence of a right to further participation. The two subsequent English cases³¹ in which the problem came up followed the *Espuela* case.³²

Thus it appears that in England, while the only case which has come up raising the question of dividend participation³³ was decided on the theory that a preference as to dividends raises an implied limitation with respect to participation in profits, the prevailing

²⁷ While it is not wise to prophesy in a branch of law depending almost entirely on construction of written instruments, nevertheless the underlying theory of the Pennsylvania cases with respect to preferred shareholders participation is that a preference is in no way a limitation, and that the preferred shareholders have all the rights of an unpreferred shareholder with their preference attached thereto. To apply this theory in the one case and discard it in the other would be a type of inconsistency foreign to the Pennsylvania appellate courts.

²⁸ *In re National Telephone Co.*, [1914] 1 Ch. 755.

²⁹ *Supra* note 15.

³⁰ *Supra* note 28.

³¹ In *In re Fraser and Chalmers*, [1919] 2 Ch. 114, the articles of association provided for a fixed preferential dividend and a preference in repayment of capital contribution on dissolution. The court held that this preference acted only as a priority in the order of repayment, and did not limit the preferred shareholders in participation as to surplus assets on dissolution. For a comment on this case see (1927) 163 L. T. 253. In *Anglo-French Music Co. v. Nicoll*, [1921] 1 Ch. 386 the memorandum was as follows: "The said preference shares shall entitle the holders thereof respectively to a fixed cumulative dividend at the rate of . . . , and to the repayment of capital before any dividend is paid or capital is repaid to the holders of the said ordinary shares, and to a further dividend calculated at the rate of etc.," It was held under this provision that the preference did not exhaust the right of the preference shareholders.

³² However, see *Collaroy Company, Ltd. v. Giffard*, *supra* note 12, where Astbury, J., after stating that he believed his decision in *In re Fraser and Chalmers*, *supra* note 31, was rightly decided, came to a result contrary to that case.

³³ *Will v. United Lankat Plantations Co.*, *supra* note 17.

view concerning participation in surplus assets on dissolution is that a preference as to repayment of "capital" contribution does not exclude participation in surplus assets.³⁴

As it is generally impossible to determine from the corporate instruments whether the stipulated preference was actually intended to add a new right to those already possessed by unpreferred shareholders, or to substitute a new right in lieu of the right to participation which would otherwise exist,³⁵ it is submitted that there are only two methods by which this problem should be treated in order to effect a satisfactory result: 1. Take a definite stand, as the Pennsylvania courts have done, either that a preference is exhaustive or that a preference is not exhaustive, and apply it in all cases where there is doubt, both with respect to dividends and surplus assets; this method, though arbitrary, would be convenient and definite in its application. 2. Adopt the theory of the Virginia court in *River-side & Dan River Cotton Mills v. Branch & Company*³⁶ and consider in each case a balancing of the equities³⁷ between the different

³⁴ It is difficult for the writer to see any difference in these two situations as a judicial problem. The question in both situations is primarily, though not exclusively, one of construction of the corporate instruments. In each situation there is a specified preference either for (1) a preference as to dividends in the dividend situation, or (2) a preference as to return of capital contribution on dissolution, and the question is whether this preference is a limitation on further participation in respect to the subject of the preference. A fixed return of capital to the shareholders in a winding up is just as much a departure from the classical notion of a shareholder as a member of the corporation and hence a peer of all other members, as is a provision for a fixed dividend. If a provision for a dividend preference is regarded as *prima facie* exhaustive as to that subject, there seems to be no reason why a provision as to a preference as to capital upon dissolution should not be similarly exhaustive.

³⁵ Of course if an implication is clear one way or the other it is not impossible to determine from the corporate instruments what the actual intent was, see *Scott v. Baltimore & Ohio R. Co.* and *Equitable Life Assurance Society v. Union Pacific R. Co.*, both *supra* note 5.

³⁶ *Supra* note 19.

³⁷ Perhaps the most important consideration in this connection would be the probable effect, of allowing or disallowing participation, upon the proportionate interests of different classes of shareholders in net earnings and net assets; see *supra* note 19. Consideration would also have to be given to the source of the fund to be distributed, *e. g.* suppose a class of shares are preferred as to capital but unpreferred as to dividends with nothing being said with respect to a limitation in either case; if the net earnings of a number of years have been accumulated with no dividend payments, a large surplus will be available for distribution upon liquidation. To hold in such a case that the preferred shareholders were limited to their preference would be palpably unjust. Furthermore, consideration might be given to the circumstances surrounding the creation of the preferred shares, *e. g.* whether they arose out of a reorganization, or as the result of a desperate need of the corporation for more "capital" at a time when money rates were abnormally high, or out of a desire of a prosperous corporation for "capital" for expansion purposes at a time when money rates were unusually low. These are factors of possible importance in interpreting ambiguous corporate instruments in an attempt to determine just what "rights" the "common" shareholders were conceding to the newly created preferred shares.

classes of shareholders; this method would utilize a pragmatic test less definite in its application.

J. C. B., Jr.

AGREEMENT TO ARBITRATE AT DESIGNATED PLACE AS CONSENT TO JURISDICTION IN THE ARBITRATION PROCEEDING¹—A contract between *A* of London and *B* of New York containing an arbitration clause provides that all controversies arising under the contract shall be arbitrated in London pursuant to the provisions of the English Arbitration Act.² Differences arise and *A* serves notice³ on *B* in New York to join in the arbitration proceeding in London. *B* disregards the notice and the arbitration proceeds.⁴ Will the award rendered in the *ex parte* arbitration or the judgment based thereon pursuant to the local law⁵ be recognized and enforced in the courts of the United States?⁶ This, of course, will depend on whether the agreement operates as consent to the English jurisdiction in the arbitration. If it does, then the judgment will be enforced in our courts. If it does not (*B* not otherwise subject to English Jurisdiction) the

¹ This paper adopts the "legalistic view", *i. e.*, arbitration is a judicial proceeding and therefore requires that the arbitration tribunal have jurisdiction over the parties. The "realistic view" considers arbitration as a substitute for a trial, a proceeding by the empowered "agents" of the parties. See Isaac, *Two Views of Commercial Arbitration* (1927) 40 HARV. L. REV. 929, *cf.* Sayre, *Development of Commercial Arbitration Law* (1928) 37 YALE L. J. 595, 600, 615.

² 52 & 53 VICT. § 49 (1889).

³ "Notice" in arbitration statute not the same as process. *Sturgis & Burn Mfg. Co. v. Unit Construction Co.*, 207 Ill. App. 74 (1917); *Mitsubishi Goshi Kaishi v. Curtens Packing Co.*, 116 Wash. 630, 200 Pac. 327 (1921). English rules of court allow service of process upon non-resident parties to an arbitration agreement. DICEY, *CONFLICT OF LAWS* (4th ed. 1927) 864, rule 8a, subhead c. Such service, however, would not confer jurisdiction over an absent defendant so that the judgment would be recognized elsewhere. *Buchanan v. Rucker*, 9 East 192 (1808). *Cf.* N. Y. Arbitration Law (1920) § 3, N. Y. CONS. LAWS (Cahill, 1930) 85, requiring service "in the manner provided by law for personal service of a summons". See *CONFLICT OF LAWS RESTATEMENT* (Am. L. Inst. 1930) § 87 (2).

⁴ English Act allows arbitration to proceed with the arbitrator appointed by the court. *Supra* note 2, § 5.

⁵ An award may, by leave of the court or a judge, be enforced in the same manner as a judgment or order to the same effect. *Supra* note 2, § 12. "... a person who has obtained leave to enforce an award may subsequently bring an action on the award, and in that manner obtain a final judgment." 1 HALSBURYS' LAWS OF ENGLAND 473 (1907) § 990.

⁶ The Federal rule is that "a judgment of a court of a foreign country is conclusive as against the defendant if, and only if, the judgment of the court of this country is conclusive under the law of the country in which the judgment was rendered. GOODRICH, *CONFLICT OF LAWS* (1927) 453. A judgment rendered by an English court would be accepted and enforced in American courts, if the court which rendered it had jurisdiction. *Ibid.*, 456.

judgment will be unenforceable for want of jurisdiction over the person of B.⁷

Consent is a frequent and principal ground of jurisdiction over absent persons not otherwise amenable to the court rendering the judgment.⁸ The consent to serve as a basis of jurisdiction must of course be actual.⁹ One may subject himself to the jurisdiction of a court by giving consent in advance,¹⁰ a common illustration being the "judgment note"¹¹ authorizing confession of judgment by an attorney of any court of record. In *Copin v. Adamson*,¹² a non-resident bought shares in a French Company, the articles of which provided that every shareholder must elect a domicile at Paris, in default of such election, he would be deemed to be domiciled at the office of a certain state official for service of process.¹³ The foreign shareholder failed to elect a domicile; a judgment rendered against him was sustained in England.¹⁴ The clause "All disputes relating to this present agreement and to its fulfillment shall be submitted to the Belgian jurisdiction" was held sufficient in England to support a Belgian judgment rendered against the absentee defendant.¹⁵

Does the agreement to arbitrate at a designated place come within the above consent principles and operate as conferring consent to that jurisdiction?

In an Illinois case the agreement provided for arbitration under an Illinois statute and that the award when made, may be filed in the court of a certain county of that state, and judgment entered thereon. On motion for judgment based on the award, the non-resident company objected to the jurisdiction of the court on the ground

⁷ GOODRICH, *op. cit.* *supra* note 6, at 459.

⁸ *Ibid.*, 140.

⁹ RESTATEMENT, *supra* note 3, § 87 (a).

¹⁰ "Consent may be given with respect to a particular action either after the action has been brought or before the action has been brought or it may be given generally with respect to actions which may thereafter be brought". RESTATEMENT, *supra* note 3, § 87 (b).

¹¹ *Teel v. Yost*, 128 N. Y. 387, 28 N. E. 353 (1891). RESTATEMENT, *supra* note 3, § 87 (3).

¹² L. R. 9 Ex. 345 (1874).

¹³ There was a provision of French law to the same effect, which the English court held did not amount to consent and on this point would not recognize the French jurisdiction over the defendant. The English courts properly distinguish between an assent contained in the articles and an assent required by general law. See *Vallee v. Dumergue*, 4 Ex. 290 (1849); *Bank of Australasia v. Nias*, 16 Q. B. 717 (1851).

¹⁴ *Amphlett, B.* "I apprehend that a man may contract with others that his rights shall be determined . . . by a foreign tribunal, and thus by reason of his contract would become bound by that tribunal's decision." *Copin v. Adamson*, *supra* note 12, at 354.

¹⁵ *Feyreck v. Hubbard*, 71 L. J. K. B. 509 (1902). A similar case is *Jeannot v. Fuerst*, 25 T. L. R. 424 (1909) ("the French Tribunals of Commerce alone to have jurisdiction"). See *dictum* of Mr. Justice Fry in *Rousillon v. Rousillon*, 49 L. J. Ch. 338, 344 (1880).

that it had not been served in Illinois. The court, overruling the objection, said:¹⁶

" . . . the defendant, by signing the agreement that the award should be filed in the Circuit Court and judgment rendered thereupon, definitely subjected itself to the jurisdiction of the Circuit Court and has authorized judgment to be entered against it, as certainly as if it had signed a power of attorney authorizing a confession of judgment".¹⁷

In *Seaton v. Kendall*,¹⁸ in a proceeding for judgment on an award of an arbitrator, it was contended that the agreement of submission must name the court which is to render judgment on the award when made in order to confer jurisdiction. The court overruling the contention said:

"No reason is perceived why, in such an agreement, a particular court must be mentioned in which judgment may be rendered. The agreement is in this regard analogous to a power of attorney authorizing a confession of judgment. From time immemorial these have been in a general form, authorizing 'any attorney of any court of record to appear in such court and confess judgment'. Yet it never has been doubted that this was sufficiently certain to authorize any court of competent jurisdiction to enter the judgment, although neither the attorney nor the court is specified by name."¹⁹

The contract in a recent English case²⁰ contained an arbitration clause providing that on failure of the parties to appoint arbitrators, this should be done by a certain officer of the marine court of Christiana, Norway, the arbitrators to meet there. The parties failed to appoint, whereupon the arbitrators were appointed by the court. An award was rendered and judgment was recovered in England for the amount of the award.

*Gilbert v. Bernstein*²¹ is one of the most recent determinations of the instant problem, and is substantially the case supposed at the outset. The contention was there made that by the specific provision of this arbitration agreement, defendants had consented in

¹⁶ *Sturgis & Burn Mfg. Co. v. Unit Construction Co.*, *supra* note 3, at 80.

¹⁷ *Cf. Rasch & Co. v. Wulfert* [1904] 1 K. B. 118, 122 (a proceeding to enforce an arbitration award). Collins, M. R., said: "There is a distinction . . . between an agreement to refer disputes and actual submission of a dispute to a particular arbitrator. A mere contract to refer disputes does not seem to me to amount for this purpose to a submission in fact to the jurisdiction of the arbitrator here, so as to give an English Court jurisdiction over him."

¹⁸ 61 Ill. App. 291 (1895).

¹⁹ *Ibid.*, 291.

²⁰ *Norske Co. v. London General Insurance Co.* 43 T. L. R. 541 (1927).

²¹ 229 N. Y. App. Div. 170 (1930) *aff'd* 135 Misc. 305, 237 N. Y. Supp. 171 (1929). (1930) 78 U. OF PA. L. REV. 905; *cf.* (1930) 43 HARV. L. REV. 653.

advance to proceed with the arbitration in Great Britain, pursuant to the provisions of the arbitration law of that country, and thus bound themselves to abide by any award there made and obtained in accordance with the procedure provided by the Arbitration Act of 1889. The court overruled the contention, attaching no significance to the provision that the arbitration was to be had at London and according to the arbitration law of Great Britain, and refused to enforce the award on the ground that it was based neither upon service within the jurisdiction nor upon voluntary appearance in the arbitration.

Whether the agreement to arbitrate at a designated place operates as consent is capable of two contrary determinations which necessarily lead to different results. Without for the moment deciding the merits of either, a consideration of the practical results reached under each may be helpful to a final valuation. If the agreement to arbitrate at London operates as conferring consent to that jurisdiction, it is possible for an award and judgment to be rendered against the party refusing to abide by the arbitration agreement in a proceeding conducted in accordance with the English Act.²² Such an award or judgment on general conflict of laws principles would be enforced by the courts of the United States.

If *Gilbert v. Bernstein* is correct in that the agreement does not amount to consent to the English jurisdiction, and *B* absents himself from England and is not otherwise subject to that jurisdiction, it is obvious that *A* can enforce his contract rights only where personal jurisdiction over *B* can be obtained.²³ An attempt to enforce the English contract in New York presents a conflict of laws case,²⁴ and it becomes necessary to determine whether the enforceability of

²² The English Act fully protects the parties' rights; § 19 provides for reference to courts of questions of law. The Uniform Act also provides that questions of law may be reviewed by the courts. (So in the Ill., Pa., and Mass. Acts but not the N. Y. Act.) See Sayre, *op. cit. supra* note 1, at 613.

²³ At common law the only remedy available for failure to arbitrate was an action for breach of the contract to arbitrate. STURGIS, *COMMERCIAL ARBITRATION AND AWARDS* (1930) 253. (For breach of agreements to arbitrate future disputes there was apparently no action. STURGIS, at 82.) Practically this right was of no value, since all that could be recovered was nominal damages. TAYLOR, *ARBITRATION AND AWARDS* (1928) 18. To exercise this right the action would have to be brought where personal service of the person refusing to arbitrate could be obtained. *Pennoyer v. Neff*, 95 U. S. 714 (1878). Arbitration statutes have made arbitration more effective by providing for specific performance in the case of local arbitration. N. Y. Arbitration Law (1920) *supra* note 3, § 3. See Sturgis, *Arbitration Under the New Pennsylvania Arbitration Statute* (1927) 76 U. OF PA. L. REV. 345. Where the party disregarding the terms of the arbitration agreement brings a suit against the other party a stay of proceedings will be granted. N. Y. Arbitration Act, *supra* note 3 § 5. If foreign arbitration is provided for in the contract, although specific performance will not be granted the proceedings will be stayed. *Danielson v. Entre Rios Rys.*, 22 F. (2d) 326 (D. Md. 1927); *Kelvin Engineering Co. v. Blanco*, 125 Misc. 728, 210 N. Y. Supp. 10 (1925).

²⁴ Goodrich, *Public Policy in the Law of Conflicts* (1929) 36 W. Va. L. Rev. 156.

the arbitration provision is a matter of substance or of remedy. If it is substance then the law of the main contract is applicable.²⁵ If it is remedy it is governed by the law of the forum.²⁶

"The forum determines what is matter of procedure and what is matter of substance according to its own law."²⁷

The English courts²⁸ have treated the enforceability of arbitration agreements as substantive, applying to them the same rules which are applied to determine the validity of the main contract. It has been suggested²⁹ that the English courts might not have taken this view in the absence of the Arbitration Act establishing a local rule favoring arbitration.³⁰ The American courts without distinguishing between domestic cases and those involving foreign elements, have treated such agreements as affecting only the remedy³¹ and governed by the law of the forum.³² The result being that although by the law governing the contract the arbitration provision is valid and enforceable, if at the forum arbitration is invalid as "ousting the jurisdiction of the court" or for some other reason,³³ the arbitration provision is refused enforcement.³⁴

It seems then that the arbitration provision amounts to nothing under *Gilbert v. Bernstein*, since it does not confer consent to the jurisdiction designated, and the enforceability of the arbitration by the vast weight of authority³⁵ is merely a matter of remedy which may or may not be given effect to, depending on the law of the

²⁵ DICEY, *op. cit. supra* note 3, at 797.

²⁶ GOODRICH, *op. cit. supra* note 6, at 157.

²⁷ McClintock, *Distinguishing Substance and Procedure in the Conflict of Laws* (1930) 78 U. OF PA. L. REV. 933, 938 citing RESTATEMENT, § 613.

²⁸ Hamlyn & Co. v. Talisker Distillery, [1894] A. C. 202. At 207 Lord Herschell said, "That clause (arbitration) is as much a part of the contract as any other clause of the contract." *Spurrier v. La Cloche*, [1902] A. C. 446.

²⁹ Heilman, *Arbitration Agreements and the Conflicts of Laws* (1929) 38 YALE L. J. 617.

³⁰ In this country, however, statutory arbitration though said to announce a "new public policy" has not affected the judicial attitude towards arbitration sufficiently to consider it as substance rather than remedy. *Berkovitz v. Arbib & Houlberg, Inc.*, 230 N. Y. 261, 130 N. E. 288 (1921).

³¹ Heilman, *op. cit. supra* note 29, at 626 *et seq.*

³² Based on a careful review of the decided cases it has been properly urged that the correct view to be taken is that the "rules which are applied to determine the validity or enforceability of the main agreement to which the arbitration provisions relate should be applied to determine the validity or enforceability of the arbitration provisions as well." Heilman, *op. cit. supra* note 29, at 617.

³³ In *U. S. Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 Fed. 1006 (S. D. N. Y. 1915) Judge Hough lists the arguments advanced against arbitration agreements.

³⁴ *Shafer v. Metro-Goldwyn-Mayer Distributing Corp.* 172 N. E. 689 (1929); (1930) 40 YALE L. J. 302.

³⁵ Heilman, *op. cit. supra* note 29, at 626.

forum.³⁶ Without considering the merits of arbitration, it may be taken that the parties, by making a provision for arbitration at a designated place, intended to accomplish something by that clause, particularly where the contracting parties are located at considerable distances from each other and disputes arising under the contract are peculiarly adapted to settlement by arbitration. It may very well be that the provision for arbitration at a named place is an important commercial inducement for entering into the main contract.

It would undoubtedly be commercially desirable to take the view that agreements to arbitrate at a designated place shall operate as consent to that jurisdiction. In the absence of some established rule of law or existing policy to the contrary, commercial convenience should prevail. If *Gilbert v. Bernstein* is correct, this desirable result may still be reached by using very careful and specific language in the arbitration clause conferring consent to the jurisdiction of the designated place.³⁷

On general consent principles, since one may subject himself to the jurisdiction of a court by consent in advance, it would seem that an agreement to arbitrate at a designated place is such a consent. A particularly strong case it would seem is presented where, in addition, the arbitration law of that jurisdiction is specifically mentioned as governing.

S. J. R.

TAXATION OF SHARE DIVIDENDS AND RIGHTS TO SUBSCRIBE UNDER STATE INCOME TAX ACTS—Since the *Eisner* and *Miles* cases,¹ federal income tax procedure covering dividends of shares in the company declaring the dividend and based on profits accruing since the federal act, and the procedure in the taxation of rights to subscribe to new shares of capital stock in the company issuing the rights has become definitely settled. Neither the dividend nor the right represents income in itself. Only when sold does any gain taxable under the federal act arise; and then only when the selling price exceeds the

³⁶ "Notwithstanding the decisions of the Court of Pennsylvania that the contract as to arbitration was valid and enforceable in that state, judicial comity does not require us to hold that such provision of a contract which is contrary to a decided policy of our courts shall be enforced as between non-residents of our jurisdiction in cases where the contract is executed and to be performed without this state and denied enforcement when made and performed within our state." Hogan, J., in *Meacham v. Jamestown R. R.*, 211 N. Y. 346, 351, 105 N. E. 653, 655 (1914).

³⁷ A similar result can be achieved by inserting a clause in the contract that service of process may be made by mailing a summons to a designated address. RESTATEMENT, *supra* note 3, § 87 (2).

¹ *Eisner v. Macomber*, 252 U. S. 189, 40 Sup. Ct. 189 (1919); *Miles v. Safe Deposit Co.*, 259 U. S. 247, 42 Sup. Ct. 483 (1921).

original cost of the shares upon which the dividend or right was based after each has been properly apportioned.²

Although much has been written regarding the soundness of these two decisions, little attention has been paid to the equally interesting and even more important side of the situation. Thirteen states now have income tax laws, and three others³ within the last year took steps to amend their state constitutions so as to allow such taxation. The problem as to whether share dividends and share rights represent "income" or "capital", and so, the extent to which each is taxable, assumes the same degree of importance here as under the federal act. It is the purpose of this note to indicate the decisions under state income tax laws on this point.

At the outset it is necessary to understand clearly two propositions. First, that although the Supreme Court of the United States has held as above indicated that under the federal income tax act both share dividends and rights to subscribe to new shares are not income in themselves, no state is bound by the decision when faced with a similar problem under its own income tax act.⁴ Second, that while a state may hold for purposes of distribution between life tenant and remainderman that share dividends and share rights are capital or income, it is not necessary for it to arrive at the same conclusions for purposes of income taxation.⁵ The states are therefore free for taxation purposes to reach conclusions which are the opposite of the federal decisions and which are the opposite of their own decisions regarding distribution between life tenant and remainderman.

² Neither share dividend nor share right is taxed until sold and then on gain only. The procedure for calculating the gain is as follows: Share Dividend—A has 100 shares in X Co. purchased at \$2,000.00 or \$20.00 per share. Receives 10 shares as share dividend. Now has 110 shares for which he paid \$2,000.00 or \$18.18 per share. If he sells for more than \$18.18 per share he has realized taxable gain. Share right—Under Miles Case, X received right to subscribe to new shares at \$150.00. Had purchased shares on which rights were based for \$710.00 a share. Sold rights at \$358.48 per right. The following was method of calculating tax.—One old share cost \$710.00. One new share could be bought for \$150.00. Two shares therefore cost him \$860.00 or \$430.00 a share. The selling price of right was \$358.48 and the purchaser had to pay \$150.00 to acquire share. Therefore total cost to purchaser was \$508.48. This minus cost of share to X (\$430.00) left \$78.48 as taxable gain. For other problems see KLEIN, *FEDERAL INCOME TAXATION* (1929) § 26:9 (c) and 26:9 (g). For recent rulings see Fathchild, *Tax Liability Involved in Sale of Stock Rights*, 7 N. I. T. M. 95 (March, 1929).

³ GA. LAWS (1929) Part I, Title III, No. 416, p. 143; KAN. LAWS (1929) c. 281, p. 453; UTAH LAWS (1930) Joint Resolution No. 2, § 3, p. 22. See also MICH. GEN. LAWS (1921) Joint Resolutions No. 2, p. 812.

⁴ *Eisner v. Macomber*, *supra* note 1, at 217, 40 Sup. Ct. at 196; *Lanning v. Tax Comm'r.*, 247 Mass. 496, 498, 142 N. E. 829 (1924).

⁵ *Tax Comm'r. v. Putnam*, 227 Mass. 522, 533, 116 N. E. 904; 910 (1917); *State ex rel. Dulaney v. Nygaard*, 174 Wis. 597, 183 N. W. 884 (1921).

Surprisingly little case authority is to be found. The income tax acts of Virginia,⁶ Delaware,⁷ New Hampshire,⁸ and New York⁹ by one device or another expressly exclude share dividends from taxation as income from the mere fact of their receipt. Each of the statutes, with the possible exception of New Hampshire,¹⁰ is sufficiently broad to warrant taxation of any gain which might be made from the sale of the share dividend. None of these statutes make any direct provision for the taxation of share rights, and only in New York is there any direct case authority. In *People ex rel. Clark v. Gilchrist*¹¹ the New York Court of Appeals held that share dividends were not "income" even in the hands of a beneficiary of a trust; and in *People ex rel. Brooklyn Trust Co. v. Lynch*¹² an order of the Appellate Division of the Supreme Court, taxing only the difference between the market value of the share dividend and right when received and the amount for which each was sold, was affirmed without opinion. In this particular group of states, therefore, no share dividend in itself can be treated as income. Any gain from the sale of the dividend is taxable, though only in New York is there direct case authority on this point. The taxation of share rights, not directly provided for in the statutes, remains indefinite, except in New York where like share dividends they are taxable as income only when sold for a profit, the tax being levied on the gain. These results differ only slightly from the methods of calculation reached under the federal act. South Carolina¹³ by its statute definitely adopts federal procedure so it also can be added to this group which treats neither share dividend nor the rights as income.

The decisions in Massachusetts and Wisconsin are sufficiently interesting to warrant separate handling. It was Chief Justice Rugg in the decision of the *Putnam* case who first voiced the view that share dividends and share rights for purposes of income taxation could be treated as income:¹⁴

"Such rights (share rights) are themselves a species of tangible property. They come to the stockholder as a gratuity. They are a new thing of value which he did not possess before. The amount for which he sells them is a gain."

This decision was all the more interesting in view of the fact that there were no direct provisions in the Massachusetts income tax law which classified share dividends or rights as income. The case was reaffirmed

⁶ VA. CODE ANN. (1930) App'x. Tax Code § 23.

⁷ DEL. LAWS (1929) c. 8, § 3, (a), (6) and § 7, (6).

⁸ N. H. PUB. LAWS (1926) Vol. 1, c. 65, § 3-II. (No provision for taxing gain derived from sale of capital assets.)

⁹ N. Y. ANN. CONS. LAWS (Cum. Supp. 1926) c. 61, § 350.

¹⁰ N. H. PUB. LAWS, *supra* note 8.

¹¹ 243 N. Y. 173, 153 N. E. 39 (1926) (reversing *People ex rel. Clark v. Gilchrist*, 211 N. Y. Supp. 679 (1925)).

¹² 251 N. Y. 569, 168 N. E. 430 (1929).

¹³ S. C. CODE OF LAWS (1922) No. 502, §§ 1, 2, p. 896.

¹⁴ Tax Comm'r. v. Putnam, *supra* note 5, at 532, 116 N. E. at 910.

in 1924, *after* the decision of the *Eisner* case, the Chief Justice again saying:¹⁵

"Even in the *Eisner* case four out of nine justices believed that a stock dividend could be taxed as income. . . . The decision of the *Putnam* case was rendered first. . . . It is adopted without more discussion as the basis of this decision."

Under these views share dividends were taxed as income.¹⁶ By statutory enactments in 1920 and 1927¹⁷ the legislature expressly excepted share dividends from taxation as income with the result that they are now taxable only when sold and apparently the federal method of calculating the gain derived from the sale thereof is adopted. Though changed by subsequent legislation, the decision in the *Putnam* case could still be cited in support of the contention that share dividends and rights were taxable as income, if the question arose in the next group of states where they are not definitely excluded from income classifications. The recent case of *Allen v. Commissioner of Taxation*,¹⁸ however, has cast considerable doubt on the authority of the *Putnam* case which to that time had always been cited as opposed to the *Eisner* case in holding that share dividends and rights for taxation purposes were to be considered as income. The court's opinion, given again by Chief Justice Rugg, held that share rights were taxable only under the sections of the Massachusetts statute providing for the sale of capital assets, and that the amount subject to taxation, therefore, was the difference between the market value of the right when received and the amount for which it was sold. This conclusion was undoubtedly justified by the act of 1928,¹⁹ but the court when faced with the *Putnam* case went on to say:²⁰

"The main point for determination in the *Putnam* case . . . was whether such gains were taxable at all as income. The method of calculating the tax . . . was not before the court. In these circumstances the statement that such rights 'came to the stockholder as a gratuity. They are a new thing of value which he did not possess before. The amount for which he sells them is a gain' was used by way of argument to show that in their nature gains arising from the sale of such rights constituted income."

Thus the *Putnam* case now stands as authority only for the proposition that if the share dividend or right is sold, the gain after deducting the market value of the dividend or right is taxable as income, a result

¹⁵ *Lanning v. Tax Comm'r.*, *supra* note 4, at 498, 142 N. E. at 830.

¹⁶ *Tilton v. Tax Comm'r.*, 238 Mass. 596, 131 N. E. 219 (1921).

¹⁷ MASS. GEN. LAWS (1921) Vol. I, c. 62, § 1; MASS. GEN. LAWS (1928) c. 217, § 1-c.

¹⁸ 172 N. E. 643 (1930).

¹⁹ MASS. GEN. LAWS (1928) *supra* note 17.

²⁰ *Allen v. Tax Comm'r.*, *supra* note 18, at 646.

entirely in accord with the first group of states under consideration and differing only in method of calculation from the federal view which considers both as capital. This becomes important in the next group of states. At any rate, in Massachusetts under existing acts neither share dividends nor rights are taxable as income.

The situation in Wisconsin, now also belonging to the first group of states, is interesting because of previous decisions. By the act of 1919²¹ share dividends were expressly included within the definition of taxable income; and under it they were taxed to the full value of the dividend whether it was sold or not.²² The court, however, placed great weight on the fact that they were expressly included in the income tax act²³ which leaves doubt as to the value of the decisions in that group of states where share dividends are neither included nor excluded in the definitions of "income". In 1927²⁴ the Wisconsin legislature provided that such share dividends should be taxable only when sold, thus adopting the federal view and providing a method of calculation seemingly in accord therewith. There are no decided cases on the taxation of share rights. It would seem, however, that under the 1927 act that they would be taxable only when sold as in Massachusetts.

Of the remaining states having income tax legislation Oklahoma,²⁵ Missouri,²⁶ Oregon,²⁷ and North Carolina²⁸ can be grouped together for neither share dividends nor rights are expressly included or excluded in statutory classifications as income. There is no case authority. To tax either as income would necessitate a decision that the dividend or right was "income" under the general provisions of the acts. The court would be without authority in so holding since the Wisconsin cases are valuable only when there is a definite legislative provision classing the dividend or right as income, and the Massachusetts decision in the *Putnam* case has been virtually overruled as conclusive authority. While a contrary result might be reached, it seems safe to suggest that this group, like the former one, would treat neither the dividend nor the right as income and would reach virtually the same decisions as the *Eisner* and *Miles* cases.

This leaves only Mississippi and North Dakota. In both, share dividends are expressly included within the definition of dividends and dividends in turn are made taxable as income. Subsequent provisions, however, expressly exclude dividends from taxation when the corporation paying or issuing them is a domestic one, and reduce the income taxation on dividends of foreign corporations proportionately to the

²¹ WIS. STAT. (1925) Vol. 1, c. 71.02 (made retroactive as of 1911).

²² State *ex rel.* Dulaney v. Nygaard, *supra* note 5; State *ex rel.* Van Dyke v. Carry, 181 Wis. 564, 191 N. W. 546 (1923).

²³ State *ex rel.* Dulaney v. Nygaard, *supra* note 55, at 608, 183 N. W. at 888.

²⁴ WIS. STAT. (1927) c. 539, § 2 subsecs. 4, 5; subsec. 5 (d).

²⁵ OKLA. COMP. STAT. ANN. (Supp. 1921) Vol. 2, c. 84, Art. XX, § 13106.

²⁶ MO. REV. STAT. (Minturn, Ann. Supp. 1927) c. 119, Art. XIX.

²⁷ ORE. CODE ANN. (Off. ed. 1930) Vol. 3, 69:1501.

²⁸ N. C. CODE (Ann. 1927) 7880:116.

income tax paid by such foreign corporations in the local state.²⁹ This would indicate that share dividends in certain foreign corporations might be taxed as income.³⁰ There are no decisions to that effect, nor are there any cases on the taxation of share rights.

By way of summary it can be said that as far as share dividends and rights are concerned under state income tax laws they have thus far been treated in practically the same manner as under the federal act, *i. e.* not as income. Of the thirteen states, six definitely exclude share dividends from classification as income by legislative enactment. One other reaches the same result by legislatively adopting the federal provisions. Of the remaining six, four states would have to reach such a decision with no precedent in other jurisdictions in order to treat a share dividend as income. In the remaining two, only share dividends in foreign corporations not subject to income taxation within the state could possibly be taxed as income; and there is no case authority even on this point. As far as share rights are concerned, there are no express provisions in any of the state acts definitely classifying them as income, and all the decided cases treat them as taxable solely on the gain when sold. It remains only to point out that here at least is a possible field of taxation untouched by federal acts. No constitutional reasons prevent states from occupying it, yet the present tendencies seem to point toward the adoption of the federal views.

T. B. D.

THE WITHDRAWAL OF THE PLEA OF GUILTY—Over-zealousness in obtaining convictions is a growing evil in the administration of criminal law.¹ It becomes particularly important to point out such an evil where the judiciary itself is a contributing cause. In recent years a great number of cases have been reversed on the ground that the trial court abused its discretion in not allowing a prisoner to withdraw a plea of guilty and to substitute for it a plea of not guilty.² For the year 1930 alone, seven reversals have been encountered where it was held that withdrawal should have been allowed.³ The only

²⁹ MISS. ANN. CODE (Hemingway, 1927) Vol. 2, §§ 5652, 5659, 5662-a, b; N. D. COMP. LAWS ANN. (Supp. 1913) c. 34, § 2346, a-1-(12) and § 2346, a-18-(7).

³⁰ For discussion concerning "Deduction Privileges" see Lutz, *The Treatment of Dividends in Income Taxation*, 33 J. POL. ECON. 129 (1925).

¹ For example of such over-zealousness that do not come within the scope of this note, see Note (1930) 43 HARV. L. REV. 617 (The Third Degree); Note (1929) 2 SO. CAL. L. REV. 283 (Entrapment).

² For a compilation of many of these cases see Notes (1930) 66 A. L. R. 628 and (1922) 20 A. L. R. 1445.

³ *United States v. Rossi*, 39 F. (2d) 432 (C. C. A. 9th, 1930); *Fowler v. State*, 153 S. E. 90 (Ga. 1930); *People v. Carzoli*, 340 Ill. 587, 173 N. E. 141 (1930); *People v. Schraeburg*, 340 Ill. 620, 173 N. E. 148 (1930); *State v.*

reversal on this ground which the writer has found in the whole history of the Pennsylvania courts, is a decision of the past year.⁴

Early writers speak of the care that the court should exercise in receiving a plea of guilty,⁵ and two old cases reveal the extreme caution with which the plea was accepted.⁶ Although these authorities speak only of a duty of precaution in receiving the plea, it was not a far step to hold that a breach of this duty was such error that the upper court would reverse the lower court and direct a change of plea. A further extension resulted in directing a withdrawal for reasons other than the breach of duty of the trial court in accepting it.

The general rule laid down by the cases is that leave to withdraw a plea of guilty is at the discretion of the trial court but the exercise thereof is reviewable if an abuse of discretion is shown.⁷ The cases do not reveal any definite test used by the appellate courts in the determination of whether there has been an abuse of discretion

Wassinger, 291 Pac. 743 (Kan. 1930); *Kelley v. State*, 288 Pac. 1001 (Okl. 1930); *Comm. v. Patch*, 98 Pa. Super. 464 (1930); cf. *Longenbaugh v. State*, 288 Pac. 611 (Okl. 1930) (It was held there was an abuse of discretion but the court only modified the sentence).

⁴ *Comm. v. Patch*, *supra* note 3. The issue has never even arisen in the supreme court. In the following lower courts this matter was discussed:—*Comm. v. Yuskis*, 11 Kulp 104 (1902); *Comm. v. Stephenson*, 9 Kulp 561 (1899); *Comm. v. Joyce*, 7 Pa. Dist. Rep. 400 (1898); *Morningstar v. Comm.*, 4 Walk. 346 (1884); *Comm. v. Gerrity*, 1 Lack. L. Rec. 430 (1878). In view of what has happened in other jurisdictions, the writer predicts that within a short time many cases shall appear in the Pennsylvania reports.

⁵ 2 HAWKINS, PLEAS OF THE CROWN, Chap. 31 § 2. "And where a person upon his arraignment actually confesses himself guilty, or inadvisedly discloses the special manner of the fact, supposing that it doth not amount to felony, where it doth, yet the judges, upon probable circumstances, that such confession may proceed from fear, menace, or duress, or from weakness or ignorance, may refuse to record such confession and suffer the party to plead not guilty."

⁶ 2 HALE, PLEAS OF THE CROWN * 225. "... but it is usual for the court, especially if it be out of clergy, to advise the party to plead and put himself upon his trial, and not presently to record his confession, but to admit him to plead."

⁷ 4 BLACKSTONE, COMMENTARIES * 329. "Upon a simple and plain confession, the court hath nothing to do but to award judgment; but it is usually very backward in receiving and recording such confession, out of tenderness to the life of the subject; and will generally advise the prisoner to retract it and plead to the indictment."

⁸ *Comm. v. Battis*, 1 Mass. 94 (1804). The court told the prisoner he was under no legal or moral obligation to plead guilty but he would not retract his plea. He was sent back to prison to think it over. Later when he persisted in his plea, the court examined the jailer, sheriff and justice as to the prisoner's sanity and whether there were promises, persuasions or hopes of pardon if he would plead guilty.

U. S. v. Dixon, 1 Cranch C. C. 414 (1807). After a warning of the consequences, the prisoner was sent back to jail. Upon being ordered back into court and again warned, he changed his mind and was allowed to plead not guilty.

⁹ *Estes v. State*, 22 S. W. (2) 35 (Ark. 1929); *Hubble v. State*, 285 Pac. 153 (Wyo. 1930); *Hopkins, Withdrawal of Plea of Guilty* (1889) 11 CRIM. L. MAG. 479. But New Jersey appears to hold that the discretion is not reviewable. *Clark v. State*, 57 N. J. L. 489, 31 Atl. 979 (1895).

because in the many factual situations that arise, courts rarely, if ever, point to one thing only as the cause for reversal.⁸ The most that can be done is to point out the various factors that have been considered and the weight that has been attached to them.

One of the main factors that appellate courts take into cognizance is the conduct of the trial judge in receiving the plea. Several states have statutes requiring the judge to explain the consequences of the plea before accepting it.⁹ One state has gone so far as to make it a misdemeanor, punishable by fine and imprisonment, for a judge to receive the plea without giving the defendant a reasonable time to "talk with a friend and an attorney."¹⁰ In addition to the reversals for the failure to explain the consequences of the plea,¹¹ there are other cases remanded because the court failed to inform the defendant of his rights before accepting his plea.¹² Thus in one case,¹³ after a plea of guilty, the trial judge put the prisoner on the witness stand and questioned him. The judge then accepted the plea of guilty and told the prisoner that counsel would do him no good. The upper court reversed the lower court with directions that the plea be withdrawn because the court accepted the plea without informing the defendant of his right against self-incrimination and of his right to counsel. The *American Law Institute's Code of Criminal Procedure*,¹⁴ although it imposes a duty of explanation, expressly says a failure to do so is not to affect the validity of the proceedings. This view is desirable because a failure to explain is often unprejudicial error as, for example, where the prisoner is an old offender.

In addition to passive misconduct, courts have been reversed for active misconduct by inducing the prisoner to plead guilty. One case

⁸ See *State v. Brown*, 33 N. M. 98, 101, 263 Pac. 502, 503 (1927).

⁹ COLO. COMP. LAWS (1921) § 7095; ILL. REV. STAT. (Cahill, 1929) 997; S. D. REV. CODE (1919) § 4741; TEX. REV. CRIM. STAT. (1925) Crim. Proc., art. 501. The Illinois statute which is practically identical with that of Colorado, reads, "In cases where the party pleads 'guilty', such plea shall not be entered until the court shall have fully explained to the accused the consequences of entering such plea; after which, if the party persist in pleading 'guilty', such plea shall be received and recorded," In Michigan, the judge must satisfy himself that the plea was freely made with full knowledge of the nature of the accusation. MICH. PUB. ACTS (1927) No. 175, ch. 8 § 35.

In New Jersey a plea of guilty is not to be received on an indictment for murder. N. J. COMP. STAT. (1910) Crimes § 107. In New York no conviction is to be had upon a plea of guilty where the crime charged is punishable by death. N. Y. CRIM. CODE (Gilbert, 1929) Crim. Pro. § 332.

¹⁰ Missouri, Laws of 1923 § 3682a p. 159. A doubt as to its constitutionality is expressed in *State v. Sublett*, 218 Mo. 1143, 4 S. W. (2) 463 (1928).

¹¹ *Mullen v. State*, 230 Pac. 285 (Okl. 1924); *People v. Carzoli*, *supra* note 3; *Krolage v. People*, 224 Ill. 456, 79 N. E. 570 (1906).

¹² *People v. Kurant*, 331 Ill. 470, 163 N. E. 411 (1928); *People v. Laven-dowski*, 326 Ill. 173, 157 N. E. 193 (1927); *Cassidy v. State*, 168 N. E. 18 (Ind. 1929); *Polk v. State*, 224 Pac. 194 (Okl. 1924).

¹³ *Cassidy v. State*, *supra* note 12.

¹⁴ CODE OF CRIMINAL PROCEDURE (Am. L. Inst. 1930) § 224.

was remanded where the judge threatened that the prisoner would get a severe sentence if he did not plead guilty.¹⁵ Other reversals reveal situations where heavy punishment was imposed after the judge induced the plea by the promise of a light sentence.¹⁶ Again, it has been held that the judge erred because he practically compelled the defendant to plead guilty in not giving his counsel a reasonable time to prepare for trial.¹⁷ In a very recent case¹⁸ the judge refused to allow the plea of guilty to several counts but said that the prisoner had to plead guilty to the whole or none. He further said the prisoner should make up his mind quickly because the judge had to go away to a meeting. Not only are judges often guilty of coercion but also prosecuting attorneys¹⁹ and arresting officers.²⁰ A defendant's contention, however, that he was induced to plead guilty by his attorney or friends is generally of no avail.²¹ But when his plea is induced by the threats of a mob, withdrawal is allowed.²²

A refusal to grant permission to change a voluntary plea is held error where the accused did not understand the consequences of his plea even though the court did not commit a breach of duty in failing to give an explanation. Such a misunderstanding of the defendant may arise from mental incapacity such as insanity,²³ illiteracy,²⁴ infancy,²⁵ or sickness.²⁶ Mistake may be the cause for misunderstanding as, for example, in pleading to the wrong indictment²⁷ or in believing that a certain mental element was not necessary for the crime.²⁸ Also along with other reasons courts have taken cognizance of

¹⁵ O'hara v. People, 41 Mich. 623, 3 N. W. 161 (1879); cf. People v. Carzoli, *supra* note 3.

¹⁶ Longenbaugh v. State, *supra* note 3; Morgan v. State, 33 Okl. Cr. 277, 243 Pac. 993 (1926).

¹⁷ People v. McCrory, 41 Cal. 458 (1871); People v. Schraeberg, *supra* note 3.

¹⁸ People v. Carzoli, *supra* note 3.

¹⁹ Reversals are generally granted for this reason. East v. State, 168 N. E. 28 (Ind. 1929); State v. Walters, 48 S. D. 322, 204 N. W. 171 (1925). But cf. People v. Jankowski, 339 Ill. 558, 171 N. E. 681 (1930).

²⁰ Fromcke v. State, 37 Okl. Cr. 421, 258 Pac. 927 (1927).

²¹ Haase v. State, 171 N. E. 811 (Ind. 1930); McDonald v. State, 118 S. 628 (Miss. 1928).

²² Nickels v. State, 86 Fla. 208, 98 S. 502 (1924); Sanders v. State, 85 Ind. 318 (1882); Kansas v. Calhoun, 50 Kan. 523 (1893); Little v. Comm., 142 Ky. 92, 133 S. W. 1149 (1911).

²³ People v. Scott, 59 Cal. 341 (1881).

²⁴ State v. Manager, 149 La. 1083, 90 S. 412 (1922); State v. Maresca, 85 Conn. 509, 83 Atl. 635 (1912).

²⁵ State v. Oberst, 127 Kan. 412, 273 Pac. 490.

²⁶ Comm. v. Patch, *supra* note 3.

²⁷ Davis v. State, 20 Ga. 674 (1856).

²⁸ Cook v. State, 138 Okl. 234, 281 P. 819 (1929); King v. Ingleson [1915] 1 K. B. 512; Appeal of Baker, 7 Cr. App. Rep. 217 (1912); Note (1927) 91 JUSTICE OF PEACE 382.

whether it was the first offense of the accused and whether he was represented by counsel.²⁹

Appellate courts have also concerned themselves with the alleged offense and its penalty in determining whether there has been an abuse of discretion. The greater the severity of the punishment the more are courts apt to allow withdrawal.³⁰ If there is a possibility that the facts as shown do not constitute the crime set out in the indictment, there is a tendency to reverse the trial court.³¹ The probability of a defense is given some weight.³² Thus one court³³ spoke of the fact that in a previous trial on a plea of not guilty, the jury had not been able to come to an agreement.

Aside from the factual difficulty in the determination of whether there has been an abuse of discretion, complications are encountered in the qualifications to the general rule of discretion. Many states³⁴ have statutes stating that the court may at any time before judgment, permit a plea of guilty to be withdrawn, and a plea of not guilty substituted. The courts of two states hold that their statutes give the power of withdrawal to the prisoner as a matter of right—Georgia,³⁵ by an express provision, and Iowa,³⁶ by judicial interpretation that "may" means "must".³⁷ The *American Law Institute's Code*³⁸ prevents such interpretation by expressly providing that it is in the court's discretion to permit a plea of guilty to be withdrawn at any time before sentence.³⁹

Although the *American Law Institute's Code*⁴⁰ speaks of withdrawal only previous to sentence and hence implies that it is not to be allowed after sentence, it is doubtful whether courts will uniformly give it that effect because under statutes providing for withdrawal before judgment it has been held that the same rule applies both before and after judgment.⁴¹ Courts are in great variance as to when

²⁹ *East v. State*, *supra* note 19; *State v. Oberst*, 127 Kan. 412, 273 Pac. 490 (1929).

³⁰ *Clay v. State*, 82 Fla. 83, 89 S. 353 (1921); *State v. Oberst*, *supra* note 29.

³¹ *People v. Carzoli*; *Kelley v. State*, both *supra* note 3.

³² *People v. Grant*, 97 Cal. Ap. 422, 275 Pac. 838 (1929).

³³ *State v. Schraeburg*, *supra* note 3.

³⁴ ARIZ. REV. CODE (1928) § 5016; ARK. DIG. STAT. (Crawford & Moses 1921) § 3076; IDAHO COMP. STAT. (1919) § 8881; N. D. COMP. LAWS ANN. (1913) § 10749; UTAH COMP. LAWS (1917) § 8900.

³⁵ GA. PENAL CODE (1926) § 971.

³⁶ IOWA CODE (1927) § 13803.

³⁷ *State v. Henderson*, 197 Iowa 782, 198 N. W. 33 (1924). For the development of this Iowa exception see Note (1924) 10 IOWA L. BULL. 158.

³⁸ CODE OF CRIMINAL PROCEDURE (Am. L. Inst. 1930) § 230.

³⁹ The New York statute also specifies that it is at the discretion of the court. N. Y. CRIM. CODE (Gilbert, 1929) Crim. Proc. § 337.

⁴⁰ *Supra* note 38.

⁴¹ *People v. Schwarz*, 201 Cal. 309, 257 Pac. 71 (1927); *State v. Arnold*, 39 Idaho 589, 229 Pac. 748 (1924); *State ex rel. Foot v. District Court*, 81 Mont. 495, 263 Pac. 979 (1928); *Morgan v. State*, 33 Okl. Cr. 277, 243 Pac. 993 (1926); *State v. Roberts*, 136 Wash. 359, 240 Pac. 3 (1925); see *McClain v. State*, 165 Ark. 48, 49, 262 S. W. 987, 988 (1924); cf. *People v. Kaiser*, 150

the request to change a plea of guilty must be made. Cases reveal the following time limits:—retirement of the jury which is to assess punishment,⁴² the entry of judgment,⁴³ pronouncement of sentence,⁴⁴ service of sentence,⁴⁵ court term.⁴⁶ Still other cases apparently hold that there is no time limit.⁴⁷ It is interesting to observe that in several cases where the lapse of time prevented the use of statutory procedure⁴⁸ in obtaining leave to change the plea, it has been held that the old common law writ of *coram nobis* could be utilized.⁴⁹

The problem as to what limit, if any, should be set to the time for withdrawal is most difficult. The arguments for a limitation are that litigation must end, and that a passage of a long period of time would handicap if not prevent the state from proving the crime set out in the indictment. If there is to be any limit, that of the pronouncement of sentence seems desirable in that it will prevent the prisoner from speculating on the clemency of a particular judge.⁵⁰ A disadvantage of this limit, however, is that the plea may have been induced by a promise of a light sentence or probation, and only after sentence would the prisoner become aware of the trickery. An especially good argument for allowing withdrawal at any time, lies in the fact that the ordinary remedy of pardon⁵¹ may be unavailable

App. D. 541, 135 N. Y. Sup. 274 (1912) (statutory authority to withdraw plea of guilty did not mean that the court could not withdraw plea of not guilty). *Contra*: State v. Van Klaveren, 208 Iowa 867, 226 N. W. 81 (1929). (But in Iowa withdrawal before judgment is in the prisoner's discretion).

⁴² See Alexander v. State, 152 S. W. 436, 437 (Tex. 1912) (A right to withdraw).

⁴³ State v. Van Klaveren, *supra* note 41. (The pronouncement of sentence was spoken of as judgment.)

⁴⁴ Comm. v. Phelan, 171 N. E. 53 (Mass. 1930); Reg. v. Sell, 9 Car. & P. 346 (1840) (Not authoritative today because at that time there could be no appeal in England, see *infra* note 48).

⁴⁵ Hynes v. United States, 35 F. (2d) 734 (C. C. A. 7th, 1929).

⁴⁶ Brown v. State, 92 Fla. 592, 109 S. 627 (1926); Morgan v. State, 33 Okl. Cr. 277, 243 Pac. 993 (1926).

⁴⁷ Sanders v. State; Kansas v. Calhoun, both *supra* note 22; see People v. Crooks, 326 Ill. 266, 272, 157 N. E. 218, 220 (1927).

⁴⁸ The ordinary procedure is by an appeal or by a writ of error on a motion to withdraw the plea or on a motion to vacate the judgment. Note (1900) 14 HARV. L. REV. 609. In England, on an appeal in a criminal case, a new trial cannot be ordered. Lawson and Keedy, *Criminal Procedure in England* (1919) § MASS. L. QUAR. 171, 215. But where a plea of guilty is entered by mistake an appeal is allowed and the prisoner must plead again and the case proceeds on that plea. Appeal of Baker, *supra* note 30.

⁴⁹ Rhodes v. State, 199 Ind. 182, 156 N. E. 389 (1927); Nickels v. State; Sanders v. State; Kansas v. Calhoun, all *supra* note 22; see Note (1923) 37 HARV. L. REV. 744, 746. *Contra*: Comm. v. Phelan, *supra* note 44, Dusenberg v. Rudolph, 30 S. W. (2) 94 (Mo. 1930).

⁵⁰ That this speculation may not be so profitable is seen in Hynes v. United States, *supra* note 45, where after a sentence of sixty days, withdrawal was granted and upon pleading guilty again the prisoner was given a sentence of three years.

⁵¹ Irrespective of this remedy, it is contended that a judgment in a criminal case for sufficient reason should be subject to attack at any time, see Williston, *Does a Pardon Blot Out Guilt?* (1915) 28 HARV. L. REV. 647, 660.

because of lack of sufficient proof of innocence even though there is justification for allowing withdrawal.

Once the plea has been withdrawn, the question resolves itself into the effect of the withdrawal. The majority of courts hold that withdrawal has the same effect as if the plea had never been made and hence, the fact of withdrawal is inadmissible as evidence in a subsequent trial.⁵² The reasoning of these courts, including the Supreme Court of the United States, is that withdrawal would be a poor privilege if the plea of guilty were admissible as evidence. The minority view treats it admissible as an ordinary confession.⁵³ Practically all the cases following the minority view, cite an old Kentucky case. In that case,⁵⁴ however, the prisoner had changed his plea without the permission of the court. Since the plea had never been properly withdrawn, it is clear that it was proper to receive it in evidence.

A logical solution of this question requires an examination of the nature of a plea of guilty. Such a plea appears to have an anomalous position in our law in view of the constitutional security of a trial by jury since the very effect of such a plea is to do away with a jury trial.⁵⁵ A close analysis shows that a plea of guilty is not what is ordinarily meant by a plea in the sense that it creates an issue of law or fact. Thus the early writers do not speak of a plea of guilty but use the word "confession" in its place.⁵⁶ Such a confession, however, is not to be confused with the ordinary confession which is merely evidence for the jury. A plea of guilty is a confession made to the judge and hence there is no necessity for a jury to make a finding on any issue of fact.⁵⁷ If the judge accepts it, judgment can be declared thereon, just as on a verdict by the jury. If the judge does not rely, or an appellate court decides he should not have relied, on this confession it seems that, *a fortiori* the jury should not be allowed

⁵² *Kerchwal v. United States*, 274 U. S. 220, 47 Sup. Ct. 582 (1926); *Jamail v. United States*, 37 F. (2d) 576 (C. C. A. 5th, 1930) (A withdrawal upon the express condition that it be told to the jury was held inadmissible); *State v. Hook*, 174 Minn. 590, 219 N. W. 926 (1928); *State v. Myers*, 99 Mo. 107, 12 S. W. 516 (1889); *Heath v. State*, 214 Pac. 1091 (Okl. 1923); *State v. Jensen*, 279 Pac. 506 (Utah 1929). In Georgia its admission is prohibited by statute, *supra* note 35. As to the admission of a rejected offer to plead guilty for a light sentence see (1929) 24 ILL. L. REV. 245. But evidence of a plea of guilty in a preliminary hearing is generally admissible. *Booker v. City of Birmingham*, 125 S. 603 (Ala. 1929); *State v. Call*, 100 Me. 403, 61 Atl. 833 (1905); *State v. Bringgold*, 40 Wash. 12, 82 Pac. 132 (1905); see *State v. Wassinger*, *supra* note 3, at 744.

⁵³ *People v. Boyd*, 67 Cal. Ap. 292, 227 Pac. 783 (1924); *State v. Carta*, 90 Conn. 79, 96 Atl. 411 (1916); *Comm. v. Ervine*, 8 Danna 30 (Kty. 1839); *People v. Steinmetz*, 240 N. Y. 411, 148 N. E. 597 (1925).

⁵⁴ *Comm. v. Ervine*, *supra* note 53.

⁵⁵ See Oppenheim, *Waiver of Trial by Jury in Criminal Cases* (1926) 25 MICH. L. REV. 695, 716.

⁵⁶ *Supra* note 5.

⁵⁷ *In re Dawson*, 20 Idaho 178, 117 Pac. 696 (1911).

to rely on it. It is true that it might be submitted to the jury with the ordinary instructions that they are to consider it only as a piece of evidence, but it cannot very well be doubted that a jury would consider it so weighty a piece of evidence that it would be almost conclusive.

In conclusion, it is repeated that trial judges should maintain the ancient protection to a prisoner who pleads guilty. Aside from pure logic or historical development, there is great social utility in showing the prisoner that his rights have been zealously guarded, since any other course would bring on an antagonistic attitude which would be a hindrance in the reformation of the prisoner.

I. P.